PHIL BREDESEN
THE GOVERNOR OF TENNESSEE

11 December 2003

Dear Investors:

When we visited in June of this year, I promised to update you on a regular basis on how we are doing in managing Tennessee's finances. At that time, we had just received notice that through the Jobs and Growth Tax Relief Reconciliation Act (the "2003 Tax Act") the state would receive $96.7 million in additional federal funding for fiscal years 2002-03 and 2003-04 to be used for general government purposes. In addition, the state received additional relief from the federal government in the amount of $46 million through the FMAP program for TennCare during the last quarter of fiscal year 2002-03 and anticipates receiving an additional $160 million in matching funds during fiscal year 2003-04. I told you that our intent at that time was to use the funds to shore up the state's financial position. I want to take this opportunity to update you on the closing for fiscal year 2002-03 and tell you how we were able to use these funds.

First on the closing itself: The general fund had a $156 million revenue surplus. The revenue surplus included $59.3 million in net state revenues consisting of $35 million in tax revenue and $24.3 million of other revenues, and the $96.7 million from the 2003 Tax Act. The use of these funds allowed the state to maintain the $178 million Rainy Day Fund Balance from fiscal year 2001-02 and provides other one-time reserves in the amount of $70.9 million. As we work our way through fiscal year 2003-04, after four months of revenue collections, we have collected $48 million above budgeted revenue estimates in the general fund.

During our meeting, I discussed with you a four step turn around process to control TennCare. I am pleased to tell you that we have successfully negotiated a truce with the Tennessee Justice Center in the four lawsuits it has had over issues in TennCare. We have also successfully implemented a preferred drug list program that is expected to generate $150 million of savings in pharmacy costs. We are, however, seeing increased enrollment of approximately 8,000 persons per month from those eligible for Medicaid (compared to those eligible under the waiver). This enrollment increase and utilization increases may mean that we have to use a substantial portion of the $160 million of enhanced matching funds in the current fiscal year.

We have engaged McKinsey & Company to analyze the TennCare program over the long-term and have asked two questions:

1. Is TennCare viable under our current management plans?
2. If not, what do we do about it?

The first portion of this report is due on December 12th with the second in mid-January. Using this information, it is my intent to present to the General Assembly a plan for how we can manage the TennCare program.

I hope this helps you understand how we are progressing in achieving our financial management goals. I look forward to hearing from you with any questions.

Warmest regards,

Phil Bredesen